

# HOUSING BOND REPORT

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## Recession, Budget Concerns Top S&P's Credit Concerns

*By Alex Ruiz, Staff Writer, Novogradac & Company LLP*

The recession's over, says Standard & Poor's chief economist David Wyss, speaking to a credit outlook roundtable last month in San Francisco. But while the good news is that it wasn't much of a recession, the bad news is that there won't be much of a recovery. Despite signs of improvement, Wyss said, his economic forecast was appropriate to the city's characteristically foggy weather on the morning of the roundtable.

Likewise in the good news, bad news category, S&P's recent credit ratings and outlooks have been mixed, with some positive news at the federal level and some negative news for states and cities.

### Federal Budget Features 'Credit Positives'

President George W. Bush's 2004 \$31.3 billion budget for the Department of Housing and Urban Development (HUD) offers some key provisions that could set HUD on a track to provide an increasing level of creditworthiness to its initiatives, says a recent report from S&P. While the budget contains some new tools to provide incentives for increasing the supply and attainability of affordable housing, S&P calls a provision to offer loan guarantees in the Public Housing Reinvestment Initiative (PHRI) "particularly notable as a step in the right direction toward attracting the capital markets' investment in tenant voucher programs."

The PHRI, originally funded in fiscal 2003, allows for loan guarantees on public-housing-property-specific financings supported by project-based tenant vouchers. A voluntary initiative, it gives public housing authorities (PHAs) an opportunity to improve the quality of housing on a project-by-project basis. The availability of loan guarantees, although limited to 80 percent of principal only, opens the door to building a new creditworthy financing vehicle for PHA programs. By providing for loan guarantees, S&P says, the federal government boosts the potential creditworthiness of a program that without the guarantees it might require more of a leap of faith than the capital markets are willing to take.

"Similar loan guarantees could greatly restore confidence in the ailing project-based Section 8 program and promote investment in new financings supported by annually renewable contracts," the report says. "They could also be especially helpful in boosting confidence in debt [that is] supported by voucher programs, especially if a new block-granting mechanism goes into effect."

S&P cites other promising aspects of the new HUD budget that pertain to increased credit quality, including a decrease in the premiums on FHA-insured programs, enhancements to the creditworthiness of the Section 538 program, increases in PHA capital, and operating funds and continuing efforts to improve HUD management. "What we would have liked to see in the president's budget was specific authority to address the deterioration of project-based Section 8, as a result of multi-year rent freezes, aging properties and escalating expenses," says managing director Wendy Dolber of S&P's public finance department.

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# Recession, Budget Concerns

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## States' Budgets Strained, Governors Disappointed at Lack of Federal Aid

President Bush's recent reinforcement of federal budget priorities that do not include additional aid to states above an expected 9 percent increase in grants comes as no surprise, S&P credit analyst Robin Prunty said last month. Governors have revealed massive gaps in their revenue estimates for fiscal 2004, which have negative credit implications for several states. Currently 10 states have negative credit outlooks.

"No state is seriously considering a massive infusion of federal resources in balancing their budgets," Prunty said. "While additional aid would be welcomed, as would mandate relief and flexibility to finance various programs, I do not believe any state is counting on this to restore structural balance to their budget."

The National Governors Association (NGA) in late February announced that it would pursue additional funding for homeland security, special education and the No Child Left Behind program. NGA chairman and Kentucky governor Paul Patton says, "These federal mandates have placed responsibilities on states, and governors strongly believe the federal government should provide additional dollars to fund."

Bush's fiscal 2004 budget proposal includes a \$384 billion rise in federal grants to state and local governments. However, even if the president's proposal moves forward in its current form, fiscal pressure will be acute for state governments that are facing a total estimated \$80 billion in budget deficits for fiscal 2004, Prunty says. Bush spoke to the NGA on February 24, and remained publicly silent on the issue of dedicating more federal funding to states, citing federal deficit constraints and the recent recession. "Federal funding will not be the panacea for state budgets in fiscal 2004," Prunty says. She notes that while a higher funding level would clearly benefit state budgets, the pace of economic recovery will be the key to restoring structural budget balance.

## Largest Cities Get Passing Grades

S&P's recently released "Public Finance Report Card: The Largest Cities" reviews the recession's effect on municipal credit ratings. Compared to states, which experienced weakened credit quality over the past 12 to 18 months, municipal ratings tend to be more stable. While only one downgrade among the largest cities occurred (Atlanta fell from AA to AA-/Negative) since January 2002, two cities, New York (A) and Dallas (AAA), had their ratings affirmed but their outlooks changed from stable to negative.

City ratings and outlooks are more stable than states' because most cities' economies tend to be less cyclical, according to S&P. State aid and funding to municipalities, which until recently have largely remained intact, also helped municipal credit ratings. "While the states felt the effect of the slowdown almost immediately, it was only recently that they started passing the pain on to munic-

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ipal governments to any degree," the report says.

This is not to say that all municipalities are performing well. In those instances where revenue mixes are more sensitive, pressures have been more pronounced. But, in general, it is safe to say that thus far, any revenue pressure experienced by localities has been less pronounced than that which state governments are undergoing. Moreover, with the duration of the current economic slowdown unknown, and the pace of recovery likely to be sluggish, S&P expects increased fiscal pressure on cities. ❖

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